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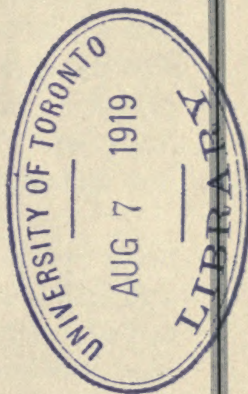
American Railways
Under Government Operation
AND THE
Financial Outlook

CHARLES E. MITCHELL

President

The National City Company

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American Railways Under Government Operation and the Financial Outlook

Fearing that some of you, hurried by the business of the day, may feel that you must leave this audience before I have fairly launched into a discussion of my subject, I am going to give you a glimpse of the last page of the book, as it were, so that you may know how the story comes out. I am going to throw my colors to the breeze at the very beginning and say that I am unalterably opposed to Government ownership and operation of railroads.

Were I to detail the reasons for such a view to an audience of Canadian business men, I would feel that I were "bringing coals to Newcastle"; for one who has studied the history of Government ownership and management of railroads in your country in the light of economics and political science, cannot help but conclude that in an adjacent country, where railroads operate under much the same conditions and where the people are equally self-governing and the institutions are equally democratic, the results of Government ownership and management would be equally disastrous. While the official figures of your Government-managed roads, over a long period of years, have told a sad but convincing story, they do not, apparently, approach in sadness the story that has been developed by those close students and commissions who have

analyzed the figures of such lines as your Intercolonial and have measured the losses sustained, when from the official operating net has been deducted interest on the investment which failed of being earned and taxes which the public would have collected had these roads been privately owned. The experience with Government-owned roads in Canada is the experience with State lines in almost every part of the globe. Most of them do not earn interest on the investment, and practically none earns the taxes which would have been forthcoming from private railways, to say nothing of the profits accruing to private capitalists under private management. A year and a third of Government operation of railways in the United States has proven conclusively that we cannot expect our case to be any exception to the proven rule, for the results have been such, that while a year ago the great majority of the American people were moderately in favor of Government ownership and operation, today the number has dwindled almost to the vanishing point. Indeed it now includes, for the most part, only the unthinking portion of that great body of railroad labor which has benefited by the free and easy dispensation of other people's money and has as yet failed to realize that, in the ultimate, labor interests will not be best served by their development as a cog in the machine of politics, and also, a few students of the situation who, worn by the struggle to see through the fog of the problem, have become so discouraged as to be willing to consign the roads to rest in peace in the arms of a paternalistic Government, which stands ready to force the taxpayer to meet any deficiency resulting from Government operation.

There is no subject today that is demanding, or, for that matter, receiving the attention of the American

business man and banker to any greater extent than is the railroad topic, and naturally so indeed, for railroads with us are a most important factor in the economic and business life. Our railroad systems aggregate nearly 260,000 miles, a mileage which is over a third of the combined railroad mileage of the world. Our railroad securities in the hands of the public aggregate over seventeen billion dollars, a sum approaching the national debt of our country, and equivalent to about twenty per cent. of total corporate securities. Railroad employes number more than two million, a number equivalent to eight per cent. of the total voting male population and approximately five per cent. of the total number of workers in the country. The railway system of the United States is our largest industry, excepting agriculture, and the rate of railway purchases, enormous in extent, absorbing, for instance, from forty to fifty per cent. of our iron and steel production, has always formed a fairly accurate barometer of business prosperity. Upon the efficient operation and the prosperity of American railroads depend, in large measure, the efficiency and prosperity of American commerce. The railroad problem is not a subject that we can treat with other than deep respect.

American railroad history, which began in 1826 with the construction on the Baltimore & Ohio Railroad, presents three distinct stages: first, the construction or development stage; second, the stage of Government regulation; and third, the stage of Government operation. In each stage abuse of power has preceded and enforced the following stage.

In the first stage, the energy of private, venture-some capital extended rail lines into every corner of our great country, gradually enabling each State to attach itself to and become a part of the political and

economic life. Railroads were eagerly sought for by every community and subsidies represented by land grants, partial payment of cost and relief from taxation, as enticements to private venture, were so extreme as often to lead to overbuilding, resulting in transference of liquid capital to permanent investment at such rapid rates as to form the bases for the panics of 1873 and 1893. During this stage the opening of the way to subsidies and the extreme desire for favorable treatment after construction, prompted railroad owners and managers to control, as far as they might, the politics in the territories in which they were interested. Thus, the so-called railroad interests became to such an extent powers in political life that in many States it became impossible to elect a candidate to public office who had not their approval. This political control by railroad interests led to many abuses and developed an anti-railroad attitude among the people, which was fostered by political leaders generally who sought preferment on that platform. This fact, combined with the high finance that was madly practiced in the flotation of new and often speculative railroad enterprises, brought to an end the great construction or development stage of railroad history, and ushered in the period of State and Government regulation.

In the second stage, the Interstate Commerce Commission, authorized by Congress in 1887, rapidly developed in power and was augmented by regulatory bodies and commissions established in practically every State of the Union. Leading political parties came to the point where they seemed to vie with one another as to which could most completely tie hand and foot the transportation companies. During this period, the Sherman Anti-Trust Law, precluding railroad combi-

nations where competition was involved and preventing the possibility of stronger roads taking the weaker under their protection, and the full-crew bills and others of like character, began to stifle efficient operation. Railroads were subjected to conflicting jurisdictions. In some of our States, they were ordered to do things which in other States it became illegal to do. One statute would order them to compete; another would prevent them from competing. And so our railroads, bound and stifled and throttled, passed through the period of excessive regulation, few living in a state of prosperity, many actually living on their own fat, and others unable to survive, forced into receivership, with eventual reorganization. From the beginning of the Great War to the time of the entrance of the United States therein, which marked the last months of this second stage, with railroad credit seriously affected by the absence of margin between operating revenue and expenses, the railroads struggled manfully to bear their burden. Their application for a fifteen per cent. increase in freight rates was refused, practically in its entirety, by the Interstate Commerce Commission, and the situation became so strained that railroad security values fell at an alarming pace. Private operation did not break down, but the system under which private operation was forced to exist—the system of Governmental super-regulation—completely collapsed. Realizing the necessity for stable credit conditions upon our entrance into the War, when Government finance in unprecedented amounts must absorb the attention of the investing public, our Government saved the situation by taking possession of all the railroads in the United States, acting under the authority of the Army Appropriation Act of August, 1916. Through the

proclamation of the President, in December, 1917, with one slash of the knife, the cords that had bound the railroads until they had cut deep into their very flesh during the regulatory period were severed. Railroad credit was restored by a guaranteed rental for the railroad property, amounting to the average operating income of the three previous operating years. Assurance was given by the President to railroad security holders that their interests would be carefully guarded, and the roads were amalgamated into one comprehensive system for service in the conduct of the commerce of the country during the War. Thus began the third stage,—the Government operation stage.

In the fifteen months which have passed since the beginning of this third stage, the railroads have well served their war mission. The President's plan of organization was simple and effective. He constituted the office of Director General of Railroads, appointing thereto the Secretary of the Treasury, who proceeded to work out an executive control by the appointment of a number of conspicuously able railroad executives. Freight rates were advanced twenty-five per cent. and passenger rates fifty per cent. The spirit of the people was high. They showed their willingness to co-operate in every possible way. They accepted their rate increases. They were charitable in their view of the service rendered. While it is fair to say that the railroads were obviously not operated to make the most favorable financial statement, it is true that there was never a time when they were operated under greater co-operation from those to whom service was rendered. The country was divided into seven great traffic regions, and for these regions were appointed Regional Directors, who were, for the most part, the presidents of leading trunk lines. On paper, the scheme was sound.

The fact that these operators, however, working to a man to the height of their efficiency and power, were unable to produce satisfactory results, and service deteriorated and morale became constantly lower, is a striking commentary on the general subject of Government operation. The roads were free from hampering restrictions and yet the net earnings fell off \$285,000,000, compared with the previous year, the railroads earning only seventy-five per cent. of the amount which the Government had guaranteed them as rental. Notwithstanding the increases in rates, which were far greater than private management had ever dreamed of asking, and which produced greater gross revenue by \$865,000,000, the people of our country, after suffering inferior service, were called upon as taxpayers to advance \$210,000,000, the amount by which the net earnings failed to equal the guaranteed rental. In other words, the American people paid \$865,000,000, more in rates for inferior service and were taxed \$210,000,000, in addition, so that the true cost to the people of one year of Federal operation amounted to \$1,075,000,000. With these figures before you, I need not repeat that the popular passion for Government ownership and operation has materially cooled during the past year.

The Railroad Administration, through appreciation of necessities of war conditions or otherwise, increased the wage bill of our railroads within one year \$965,000,000, which advance followed an advance made by the companies themselves in the previous year so that the total advances in the yearly wage bill arising since our entry into the War are no less than \$1,260,000,000. The annual wages paid by our railroads to-day aggregate \$3,000,000,000,—an amount equivalent to the gross earnings of all roads during

the year 1915. Considering that the war-time increase in prices of railroad materials has added to operating costs between \$500,000,000, and \$600,000,000, annually and that the yearly wage scale has been increased by \$1,260,000,000, while the entire advance in rates has added only about \$1,000,000,000, to annual railroad revenues, it will be clearly seen that the railroad financial situation is far worse than it has ever been before. Much as we may dislike the thought, a further increase in rates to compensate, in large measure, for this increase in operating expenses, is inevitable. While there may be some hope that the cost of coal and rails and other supplies may come down and the increased volume of traffic may compensate for such increases as remain, it is difficult, in view of the political aspect of the situation, to believe that railroad wages will lend themselves to reduction under the natural laws of economics as will the industrial wage. A rate increase equivalent in result to the wage increase should, unquestionably, be made forthwith.

It would seem unfair, in thus presenting the financial results of Government operation, not to mention the claimed savings and benefits as presented by the Administration itself. The Administration has very properly extended the joint use of terminal facilities and consolidated the several city ticket offices in the principal cities of the United States. Such unifications have probably saved \$20,000,000, annually. It has discontinued the maintenance of off-the-line traffic soliciting agencies, at a claimed saving of \$13,000,000, per annum and has abolished the advertising expenditures in connection therewith at a claimed saving of \$7,000,000, annually. It has materially reduced passenger service at an estimated saving of \$80,000,000, per annum, which saving, I may add, represents a war

economy which the American public has accepted purely as such. It has effected a saving in car mileage through the routing of cars via the shortest route, which saving in the Eastern and Northwestern operating regions has been estimated as high as two-tenths of one per cent. of the total car mileage. It has, by virtue of operation under the unified system, succeeded in handling two per cent. more freight ton mileage and nine per cent. more passengers one mile than in the last year of private operation. These savings and advantages are manifestly infinitesimal as compared to what the American people know and can see concretely,—deterioration of service and an effect upon railroad finance so alarming that, were the roads to be returned to private ownership under conditions today existent, a majority of our companies would be faced with bankruptcy.

The time has come to solve the problem of the future for the railroads and the longer the delay, the more difficult the solution. The Administration has suggested that Government operation continue for a further period of five years, in order that it may be more thoroughly tested. This suggestion has met with marked opposition and apparently it has been dropped by its original advocates. While it is in the power of the Administration to turn the railroads back at any time and immediate return has been threatened, assurances have been recently given that the railroads will not be returned in a way to bring disaster, which surely means that they cannot be abruptly returned. To fix a date, even that date provided in the law, namely twenty-one months after the declaration of the ratifications of the Treaty of Peace, as the date when the roads shall be returned, would seem the height of folly. The railroads should be, and probably will be, returned when a sane and sound plan for their return has been devised.

Suggestions for the return and subsequent method of operation and regulation have been many. Plans have been submitted by the Railway Executives, by the Association of Railway Security Owners, by the Interstate Commerce Commission and the Director General himself. Railroad presidents and bankers have expressed their views and the Railroad Brotherhoods have produced for consideration a most socialistic suggestion. Many of the views expressed in these plans are admirable, though for the most part, they involve the laying of the railroad structure upon the operating table and performing upon it major surgical operations that will result in making it little resemble that transportation system which has served so well our public in the past. They propose such physical and financial readjustments of the railroad situation as, in my opinion, would leave the patient weak and disfigured and unable to bear the burdens which American commerce must throw upon him without interruption.

Most of the plans provide for guaranteed minimum profits to the roads and a maximum profit return. I am personally opposed to the minimum guaranty suggestion, for I believe it to be a definite step toward Government ownership, especially if private management fails to earn the income guaranteed. I believe it will take from private initiative a fear of failure, which is, in itself, a spur to achievement. I do believe, however, in a fair division of profits above a specified maximum, but I cannot believe in fixing a point in profits above which all excess goes to others than the railroads. Rate making in itself must be largely determined by the expense of operation, not of one road but of all roads involved in the specific rate made. If operating on such a rate, the poorly located or poorly managed road is to be given a chance to live, the well

located and highly efficiently operated road will find such rate extravagantly profitable. Such excessive profits should, I believe, be divided with the Government and others as in the judgment of our Congress seems proper, but the spur to achievement in operation that results in high profits should never be taken away by placing a fixed maximum return on any road. In many of the plans suggested, an attempt is made to arrive at a method—a precise formula, as it were—for the establishment of equitable rates, and some definitely suggest a regional combination of roads. I cannot believe that this is the time to attempt to figure out theoretically a rate formula or what combinations of roads should in the ultimate be made. Given a properly constituted Interstate Commerce Commission of truly representative men with authority for the development of rates, as a result of a study, experimentation and adaptation, combined with legally delegated responsibility to see that such rates be commensurate with operating expenses, a Federal Commission having jurisdiction over intrastate as well as interstate commerce so far as the laws permit, but in any event working with greater harmony than heretofore with various States, through, perhaps, regional advisory boards, composed of State representatives, of shippers and of labor,—then I feel that we have gone as far as we can along the lines of rate fixing.

Perhaps the thought that I would contribute to the discussion leading to the solution of the railroad problem may be of interest. It is based upon the conclusion that Government ownership and operation is not practical; that private ownership and operation, freed from Government regulation, has been shown by history to have its dangers and is not feasible; and that the situation must be worked out under private

ownership and operation under fair and equitable regulation, the solution to be found with as little disturbance as possible of structures already existent.

Three things appear to me essential to be done before consideration is given to the return of railroad property to private operation: first, the reconstruction of the Interstate Commerce Commission, with rate-fixing authority and responsibility definitely established; second, an immediate rate increase sufficient to take up the burden of the wage increase granted during Government operation; and third, the passage of such legislation as will provide for a division of profits above what shall be determined to be a reasonable return to invested capital. With these things accomplished, we should be ready for private operation. That complete severance from Government responsibility for railroad credit should be immediate and for every road at the same hour, seems to me, however, a preposterous suggestion. The corner to be turned must not be a sharp one. The return must be gradual, both in method and point of time. I feel that the Government should continue its guaranty of standard rental return as now established for such a period, probably two to three years, as will enable private managements to get back a firm hold upon their affairs. Under such continuance of guaranteed return, let the Government turn back the properties with reasonable working assets to the private owners, leaving for gradual settlement and adjustment the counter claims inevitably to be made as between the Government and the private owners for later but as early an adjustment as may be possible. Let private management reinstate itself, with the requirement upon each road to pay over to the Government any excess over the Government guaranteed rental return and with the right to call upon

the Government during the guaranty period for any deficit between its net operating revenue and such guaranteed rental. But let there be provision that at any time during this two to three year period of continued Government guaranty, any railroad company may, if it so elect, release the Government from its guaranty and receive thereafter the full net return resulting from its operations, subject to a division of excessive earnings as heretofore suggested. I am of the belief that, under this plan, the owners of the majority of our large railroad companies would release the Government from its guaranty within the first year, and that the roads continuing to work under the guaranty to the end of the period, which would naturally be the weakest of the companies, would be comparatively few. The financial condition of such remaining companies will doubtless be such that drastic reorganizations will be necessary at such time as the Government guaranty ceases, and I would consider it more than likely that at such time the Government would deem it wise to give its permission, present laws to the contrary notwithstanding, for absorption and consolidation of such roads in the stronger systems. Thus, would the roads return to private management under the same incentive to the development of efficient competitive service that has made the railroad system of the United States the model of the world. I recognize that this plan of adjustment involves many complexities which will demand co-operative effort and well considered legislation to solve, but I do feel that the plan subjects the problem to comparatively simple and effective treatment.

The railroad problem is only one of our great problems of the adjustment period through which we are

now passing, but it is entwined with practically every other problem of the day,—the problem of labor, of inflation, merchant marine, and even the problem of our export trade,—for, as you know, the railroad item enters into the cost of goods delivered at seaboard for export to a greater extent than in any other country, with the possible exception of your own. It would be interesting indeed, were there time, to trace the windings of the knot which entwines other adjustment problems with this great railroad problem. The minds of American business men, however, are distinctly upon these many problems, and in that thought alone we may be optimistic that they will be solved aright.

Conditions in our country are, on the whole, exceptionally good. A uniformity of conditions and a uniformity of thinking, throughout the length and the breadth of the land, exists as I have never before seen it. Wages are everywhere high, and there is no marked degree of unemployment anywhere. Bolshevism is being trampled down wherever it shows its head. Merchants are doing a large and profitable business. Manufacturing establishments that were busy in war industry are idle in many places, but plans are developing for their activity in lines of peace industry. The War has opened up our natural resources to a degree never before known in history, and our power to produce in quantity has increased apace. Our financial conditions are exceptionally good. We have inflation, of course, but withal, an inflation that is less than that which exists in almost any other part of the world. Our Victory Loan campaign, which opens to-day throughout our country, gives promise of being a huge success. By and large, the fundamental conditions in the United States are sound. We have, to

be sure, many questions for which we have yet to find the answer, and not the least of these is as to where we are to find a market for our goods. The development from a debtor to a creditor nation has brought its difficulties, as well as its responsibilities, and among those difficulties is the sharp advance in dollar exchange, which impedes the opening of foreign markets for our exports. The maze of the railroad situation would seem to preclude the possibility of the railroads becoming active purchasers in volume immediately, and as I have suggested before, the rate of railroad buying is usually a barometer of the prosperity of the times. On the other hand, agricultural conditions are so abnormally good with us that we hope the farming communities will enter our markets as exceptionally heavy buyers. Winter wheat was reported, on April first, as in practically 100% perfect condition, comparing with 78.6% a year ago and a ten-year average of 82.3%. The ground condition is everywhere good, and a bumper year is expected. All things considered, the favorable conditions would appear to at least offset the unfavorable conditions with which we are confronted, and, while I will not predict a year of tremendous commercial activity, as compared with the years of the War, nevertheless, I feel that a year of at least moderate prosperity is assured.

One thing is certain—the immense wealth of the United States to-day and its unprecedentedly strong position as a creditor nation not only makes favorable the conditions for, but enforces the seeking of, foreign investments. In that way only, in my opinion, can inequalities of exchange such as exist between Canada and the United States today, be overcome, and I am satisfied that our people are only awaiting the oppor-

tunity to invest their capital on this side of the border. The investment banking company which I represent, looking forward to this development, has recently established its offices in your Canadian cities. With other investment bankers of the States, we hope to be of assistance to you in your development and of assistance to our own nation in the development of its commerce by bringing American dollars to your land for investment and thus adjusting the rate of exchange, to the end that there may be a free and easy movement across that imaginary line which separates commercially and politically your people and mine, who, after all, are one in blood, in method of thought and in purpose.

